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SUBJECT: PANAMA: GOP SEEKS TO PROVIDE RELIEF AGAINST
INFLATION

REF: PANAMA 184

¶1. (U) SUMMARY. During the March 1, 2008 National Assembly inaugural speech, President Martin Torrijos presented a \$110 million fiscal package, aimed in large part to ease the impact of higher inflation. The package provides continued energy subsidies, a middle class tax cut, increased mortgage subsidies, and elimination of tariffs on certain foods not produced locally. END SUMMARY.

Torrijos Announces Plan to Ease Inflation Pain

¶2. (U) During his March 1, 2008 National Assembly inaugural speech, Torrijos presented a \$110 million fiscal package which includes a middle class tax cut of approximately \$43 million. Most of the announced measures are designed to help consumers cope with higher inflation by increasing disposable income. None of the measures are designed to lower inflation by lowering demand or tightening fiscal policy. As the U.S. dollar is the official currency, the GOP has no monetary tools to combat inflation.

¶3. (U) Torrijos blamed inflation on international factors outside of the GOP's control. Specifically, he cited rising oil prices (increasing production costs), the falling U.S. dollar (raising import costs), and growth in China and Asia (increasing demand). Panama is experiencing its highest inflation rate in over 26 years with inflation running at a 7.6% annual rate as of February 2008. Various basic food items have risen 10%-25% in each of 2006 and 2007.

Energy Subsidies to Continue

¶4. (U) Torrijos said the GOP will maintain its subsidies on electricity and liquid gas purchased in small tanks. Currently, the GOP subsidizes approximately 672,000 households (90% of Panamanians who have access to electricity). Individuals not subsidized have seen their electricity bills increase almost 400% over the last three years. The GOP has a program allowing poor Panamanians to purchase liquid gas with a market value of \$12.37 for \$4.37. During 2008, the GOP's Ministry of Economy and Finance (MEF) estimates energy subsidies (including liquefied gas) will be \$149.1 million.

Middle Class Tax Cut

15. (U) Torrijos also said the GOP will eliminate all income tax on individuals earning between \$800 and \$860 a month (approximately 40,000 individuals) starting in 2008, and on all individuals earning between \$860 and \$2,500 a month (approximately 70,000 individuals) starting in 2009.

Currently, individuals earning less than \$800 a month do not pay income tax. The GOP estimates the average worker earning between \$800 and \$860 a month would save \$26 a month. The GOP estimates the value of the tax cuts for 2008 to be \$8 million and \$35 million in 2009. Under current law, once a worker exceeds \$800 a month, he pays tax not on the marginal income but the gross income. As a result, modest salary increases result in a tax bill exceeding the wage increases.

16. (U) If the tax cuts were implemented as of December 31, 2007, only 18,750 salaried workers nationwide would have paid income tax. Currently, approximately 125,000 salaried workers pay income tax.

Mortgage Subsidies to Expand

17. (U) Torrijos also announced that the GOP would provide a 100% subsidy on all mortgages on houses valued at \$30,000 or less. Also, the program to provide subsidized mortgage interest payments on homes valued at \$62,500 or less would be extended. Under the new plan, the subsidized mortgages rate (currently 3.5%) would be available to houses valued at \$80,000 or less. The preferred rate would apply on the first \$62,500 and the market interest rate on the balance (currently between 5.5% and 6.0%). During 2008, MEF estimates the cost of the subsidized mortgage program will be

\$15 million.

18. (U) According to the Panamanian Banking Association, 85% of all mortgages are for homes valued at \$50,000 or less. Only 4.9% of all mortgages related to homes exceeding \$100,000. The Panamanian National Council of Home Promoters (CONVIENDA), who represent 59% of all real estate brokers in Panama, reported that 75% of homes sold by the members were valued at \$62,500 or less. The construction and real estate brokerage industry had lobbied for the subsidized mortgage rate program to extend to homes values at \$85,000 or less. Such groups have claimed the increase limit was necessary, in large part, due to higher building costs. CONVIENDA reported that the average value of its home sales have risen 10.4% in 2007 and 7.9% in 2006. According to CONVIENDA, its average home sales price has risen from \$71,473 in 2006 to \$85,149 in 12007. Juan Carlos Mastellari, President, Panama Association of Business Executives, said the extension of the subsidized mortgage program will cause an overheating of the construction sector. During 2007, the construction sector grew by 25%.

Elimination of Tariffs on Some Foods

19. (U) Torrijos also announced the removal of tariffs on certain foods not produced domestically. The full list of such products has not been determined, but on March 11, 2008, GOP Agriculture Minister Guillermo Salazar said that it would include apples, pears and peaches.

Other Announced Measures

10. (U) In addition, to the items listed above, Torrijos announced plans to increase the police force by 2,000 officers, incentive to 40,000 subsistence farmers, increased assistance to rice, dairy, beef, poultry and vegetable producers, and pay increase for 4,000 teachers who work in isolated areas. During 2008, MEF estimates total

agricultural subsidies will be \$15.1 million

Comment

19. (U) Given the GOP's \$686 million fiscal 2007 surplus (see reftel), the cost of these measures will not affect significantly the GOP's fiscal account. The measures, however, are contradictory to the recommendation in the March 4, 2008 IMF Assessment Letter which states that, "Given the higher inflation and continued risk of overheating, a tighter fiscal stance than that which had been envisaged at the time may be advisable." The 2007 budget surplus is almost equal to the estimated costs of all GOP subsidies for 2008 (\$683.7 million). Two noteworthy aspects of the Torrijos speech was (1) blaming everyone but the GOP for inflation and (2) the lack of any measures to lower the cost or allow for the importation of cheaper foods to compete against the more costly domestically produced foods, such as rice, potatoes, and onions.

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